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ROLE OF TRUST IN BANK-SME RELATIONSHIPS

Master's Thesis
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Abstract of master's thesis

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Abstract

According to Degryse and Cayseele (2000) small businesses often complain about being unable to get money from banks at affordable rates. They argue, that borrowers can mitigate the problem by building a strong relationship with the lender. Having access to sufficient debt financing is crucial for small and medium sized enterprises (SMEs). However, evaluating the creditworthiness of SMEs is a challenge for banks, because the availability of public information is much lesser than in case of larger corporations and with enterprises, that have a long history. Previous studies argue, that in addition to the (mandatory) hard data, banks should utilize private information such as growth estimates, immaterial rights and innovations. However, the SMEs often think that this kind of information is sensitive, and they do not want it to end up in the wrong hands. Because of trust issues the SMEs might not be willing to provide banks with this additional information. Scholars argue, that if the SMEs trust their banks and provide them this additional information, they are more likely to obtain the credit they need. This study aims to find out what is the role of trust in the bank-SME relationships. The context of this study is Finnish society where trust is high and the bank-SME relationships; the institutions that give the loans, the companies that need the loans and the relationships between these two entities. There is a lot of literature on trust itself, but there is a limited understanding of the role of trust in SME financing and this study will contribute to that area of research. The research in understanding the startup and SME financing has been increasing, but a limited understanding of the area remains.

Keywords Bank-SME trust, bank-SME information asymmetry, bank-SME lending process

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Abstract of master's thesis

Tekijä Lassi Kervinen
Tutkielman aihe Luottamuksen rooli pankkien ja PK-yritysten välisissä suhteissa
Tutkinto Kauppatieteiden maisteri
Koulutusohjelma Yrittäjyys ja innovaatiojohtaminen
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Tiivistelmä

Degrysen ja Cayseelen (2000) mukaan pienet yritykset valittavat usein, ettei kohtuullisen koron pankkilainoja ole saatavilla heille. He väittävät, että lainanhakijat voisivat parantaa tilannetta rakentamalla vahvan suhteen rahaa lainaavaan tahoon. Pääsy riittävän rahoituksen piiriin on elinehto pienille ja keskisuurille yrityksille (PK-yritykset). Toisaalta tällaisten yritysten maksukyvyn arvioiminen on pankille haasteellista, koska julkista tietoa on saatavilla paljon huonommin, kuin mitä esimerkiksi pitkän toimintahistorian omaaviin yrityksiin tai pörssiyrityksiin liittyen on julkisesti tarjolla. Aikaisemmissa tutkimuksissa on todettu, että (pakollisen) kovan tiedon lisäksi pankkien tulisi hyödyntää yksityistä tietoa, kuten kasvuennusteita sekä tietoa immateriaalioikeuksista ja innovaatioista. Toisaalta PK-yritykset usein kokevat, että tällainen tieto on arkaluontoista, eivätkä he halua sen päätyvän vääriin käsiin. Luottamukseen liittyvien kysymysten takia PK-yritykset eivät välttämättä halua antaa pankeille kaikkia tietoja toiminnastaan. Tutkijat väittävät, että PK-yritysten todennäköisyys saada hakemansa laina nousee, jos yritykset luottavat pankkeihin ja jakavat heille vapaasti tietoa. Tässä tutkimuksessa pyritään selvittämään mikä on luottamuksen rooli pankkien ja PK-yritysten välisissä suhteissa. Tutkimuksen kontekstina on suomalainen yhteiskunta, jossa luottamuksen perustaso on korkea, sekä pankkien, eli lainoja antavien instituutioiden, sekä lainoja hakevien PK-yritysten väliset suhteet. Luottamukseen liittyvää kirjallisuutta on olemassa paljon, mutta luottamuksen roolista pankkien ja PK-yritysten välisissä suhteissa löytyy vähemmän kirjallisuutta. Tämä tutkimus pyrkii paikkaamaan tätä aukkoa. Startup-yritysten ja PK-yritysten rahoitukseen liittyvän kirjallisuuden määrä on ollut kasvussa, mutta lisää tutkimusta tarvitaan edelleen.

Avainsanat Pankkien ja PK-yritysten välinen luottamus, informaatioasymmetria pankkien ja PK-yritysten välillä, lainaprosessit pankkien ja PK-yritysten välillä

1. Introduction

1.1 Background

Cassar (2004) found out, that startups with intentions to grow seemed more likely to use bank financing and they wanted to establish strong credit relationships as early as possible. Having access to sufficient debt financing is crucial for the small and medium sized enterprises (SMEs) in order to survive and develop. This makes sense, because companies need money for growth and debt financing is normally cheaper than (outside) equity financing; a pecking-order theory by Myers & Majluf (1984) suggests, that because of information asymmetries new equity holders require a higher rate of return for their investments. Also, greater information asymmetry leads to higher risk. Thus, Myers & Majluf argue, that firms prefer inside finance to debt, short-term debt over long-term debt and any kind of debt over outside equity. However, the lenders are found having a hard time making a distinction between the “good” entrepreneurs who will repay their loans back and the “bad” entrepreneurs, who will not repay their loans (Diamond, 1984). There is much fewer public data of the SMEs available, because they do not have to provide the same amount of public information as a listed company is required to. Also, many of the SMEs might have been founded just a year or two ago. Thus there is less historical data available as well. In addition, the available public information (such as financial statements and interim reports) is often retrospective, and because of that it is not that useful in forecasting the future potential of a growth-oriented company (Moro, Fink & Kautonen, 2014). There is some "mandatory” information (financial data), that a bank asks to see when an SME is trying to get a loan. Other information, such as covenants and collateral, are also often requested. In previous studies it has been argued, that providing the banks with more information than just the requested (“mandatory”) ones, can help an SME to receive the loan it is trying to get. This additional information could include for example growth estimates and information about immaterial rights and innovations. At this point the trust between the SMEs and the banks comes up. Most likely many SMEs would include it in their strategy to provide this additional information in order to improve their probability of getting the loan, if they could be sure, that this information which they might consider sensitive, is not used in improper ways. I understand that the SMEs worry over their data, because for a young enterprise a product or a model might be everything valuable they have at an early stage. Also, SMEs might also worry about how bank uses the information; how it is stored, who can access it and can it be used against the SME in any circumstances. When thinking of traditional banks, the bank secrecy requirements are the core of their business and solely that might be enough to convince most of the SMEs that their information is safe. However, it needs to be studied whether this is the case or not and how to deal with the SMEs that think that the bank secrecy requirements alone are not enough to gain their trust.

According to Berger & Udell (2006) ”better” lending infrastructures could improve the credit availability of SMEs through facilitating the use of various lending technologies. Similarly, a “worse” lending infrastructure could reduce the SME credit availability. Reducing the information asymmetry would benefit everyone else but the entrepreneurs, who are not able to pay their loans back. As a result of the reduced information asymmetry banks could have faster lending processes and lower risks of credit defaults and the SMEs could also have faster lending processes and perhaps receive lower interest rates. Higher level of trust would most likely lead to less information asymmetry, as SMEs in a higher trust environment there would be less friction in sharing information with the bank.

1.2 Research objective and research questions

The objective of this study is to find out how trust between banks and SMEs is established and how it affects the lending process. The first task is to find out and understand how trust is established between these two entities, banks and SMEs. The main question research question to be answered is “How is trust between banks and SMEs established and how it affects the lending process?”, and research on it starts from the point when different banks and SMEs hear from each other for the first time or start working on their first lending process together. Understanding this provides a good base on which the further research could be built on. Trust can be built and destroyed in many different ways. Thus, it is important to find out how trust is established between banks and SMEs and how it is maintained, and it can be strengthened. This study focuses mostly on bank’s perspective, but bits of SME’s perspective are included as well..

Trust is a complicated matter and it has different basis and different meanings to individual entities. Thus, it is important to understand what trust means for different entities and why does it matter. It is important to find out how increased trust affects the lending process and what other effects it might have. Mutual understanding is also important it would be beneficial for any relationship if the participating entities can perceive each other’s needs efficiently and correctly. Additional point to touch is to find out what kind of lending models are used when in the process when an SME is looking for a loan. In addition, it is important to see what other factors affect the whole lending process. For example, understanding the definitions and roles of so-called soft data and hard data are important and this study touches upon them as well.

In 2011 Chua, Chrisman, Kellermans & Wu found out, that relationships with lenders and access to larger amounts of funding could be improved by mitigating agency problems related to the companies with better preparations and other assurances on the creditworthiness of the entrepreneur and the company. However, they argued, that these aspects of social capital require further study. They also emphasized, that future research should be conducted on how other aspects of the relationships between the lenders and the borrowers should be managed. Both financial and non-financial aspects should be included. Additionally, Moro & Fink (2013) point out, that further research could investigate how trust between loan managers and entrepreneurs could be stimulated in the early stages of the relationship and furthermore nurtured during the life of the relationship.

I assume, that trust is built by having discussions and sharing information. However, refusing to share requested information could lead to declining trust. I am not sure how providing more information than the bank has requested would affect the lending process, because banks might request the information they need, and additional information might not be useful to them. I think face to face meetings and the impressions of a person or a group of people are an important factor in the trust building process as well. It might be so, that not just the data provided, but also intuition has a role in the process of establishing trust. I assume, that a strong relationship and high level of trust between a bank and an SME could lead to faster and more simple lending processes and perhaps even lower interest rates. However, additional research must be conducted in order to find out whether my assumptions are correct or not. I think that by working the main research question and matters around it would provide a nice broad view on the research objective.

2. Literature review

In this chapter I go through the main findings that I made while I was reading articles and studies about trust. First I will go through agency theory and why trust matters. Then I will move on to different lending models which are used with SMEs. Finally, I move on to sources of trust and how trust works.

2.1 Agency theory

Principal-agent theory is not so commonly used in trust research. For example, Sheppard & Sherman (1998) argue, that trust has been treated as an unsustainable phenomena or irrational risk taking in about agency theory literature. This might be one of the reasons, which could explain the relative absence of agency theories in literature, which is related to trust and the implications of it. However, Möllering (2006) argues, that the basic construction of principal-agent theory models the problem of trust. The theory brings up several problems, that are associated to situations where the actor, who is described as principal, hires another actor (agent) to perform an action or series of actions to get a reward or rewards in return. In many cases the principal believes, that the agent might not always act in the best interest of the principal (Jensen & Meckling, 1976). In addition, according to Hendry (2002), the agent is a rational self-interested actor, which ultimately leads to behavior where one tries to minimize their effort if the reward is not outcome-based. Later in this study it is pointed out, that higher level of trust leads to positive effects in the bank-SME relationship. Thus, one can see clear outcome-based rewards when a SME representative (agent) works in a way which reduces information asymmetry and increases trust between the SME and the bank (principal). In this kind of a setting the principal is a trustor and the agent is a trustee.

About agency costs Möllering (2006) argues, that they consist of the difference between the principal's gain (a situation when the agent puts in a proper amount of effort) and lower gain, which is based on the agent's actual effort. Also, more agency costs arise when principal undertakes any initiatives to ensure that the agent is putting in proper amount of effort. On the other end of agency costs are the costs that incur when the agent keeps in connection with the principal and informs them about, e.g., capabilities, intentions and commitments. Nooteboom (2002) argues, that of course relations carry costs, because they require social and cognitive capital. However, he argues, that without these costs the relationship would not be fruitful, and these costs enable relations that would not be possible otherwise. In the end Möllering (2006) argues, that the principal-agent theory seeks to explain the existence of these kind of exchange relationships and how they are organized by looking for a balance between benefits and costs related to the agency. Moro et al. (2014) argue, that in bank-SME relationships traditional coordination mechanisms often increase agency problems rather than reduce them. Thus, they suggest, that loan managers should have an alternative in lending processes based on relationship lending, which would promote voluntary disclosure and reduce information asymmetry by increasing knowledge of the entrepreneurs' competence. Möllering (2006) also gives thought on how relationships between principal and agent should be constructed in a way, that makes them attractive. A re-phrased version of the question is that what it takes for an agent to appear trustworthy to the principal so that the principal would be willing to hire him? There is a similar setting in this study. However, in this study the focus is in how does the SME representative appear trustworthy so that the bank is willing to give the SME funding.

2.2 Lending models used with the SMEs

Moro & Fink (2013) argue, that research on SMEs divides the lending techniques into four main categories, which are financial statement lending, asset-based lending, credit-scoring lending and relationship lending. Financial statement lending is based on the information found in the financial statements. Asset-based lending is based on provisions of collateral and its quality. Credit-scoring lending is based on statistical techniques, mostly hard information, but also information about the SMEs owner and information of the firm itself (Berger & Udell, 2006). This information might also include assessments of the future of the SME gathered from past communications with such entities as SMEs suppliers, customers or neighboring businesses. (Berger & Udell, 1995; Degryse & Cayseele, 2000; Petersen & Rajan, 1994). In relationship lending the financial institutions rely mostly on the soft information that has been gathered over time during the relationship with an SME, its owner and the local community (Berger & Udell, 2006). However, Moro & Fink (2013) argue, that the first three lending techniques are usually grouped together and labelled under "transaction lending", because the risk evaluation is based on the public (factual) information available that it is independent of the quality and the length of the relationship and these loans are mainly used for serving non-recurrent needs. Berger & Udell (1995) argue, that in relationship lending the information gathering goes beyond the relatively transparent data that can be found in official documents. Previous studies argue, that SME financing does not rely on a single model at a time, but more likely a combination of different models with difference in the weighing of them are used.

Berger & Udell (2006) argue, that prior studies suggest that transaction lending (lending based on publicly available financial data) is not able to properly satisfy the financial needs of the SMEs and because of that effective alternatives or additions are needed. There are many ways evaluate whether an SME would pay its loan back or not. To solve this problem they suggest using a three key characteristic model of relationship lending (Berger & Udell, 2002) that consists of 1. relationship lending depending on the soft information, 2. loan officer having the most important relationships with the firm, owner and the community and 3. an agency problem between loan officer and the bank management, as the soft information is harder to transmit. Thus, they argue, that some organizational structures may be better in resolving the contracting problems related to relationship lending; especially small banking institutions with fewer managerial layers might have fewer contracting problems between the management and the loan officer.

Based on earlier research a common finding is that in large companies have advantage in lending transactions that are based on ”hard” quantitative data and small institutions benefit have advantage in transactions that are based on ”soft” and more qualitative information (Berger & Udell, 2006). Also, foreign-owned institutions might get advantage in transaction lending, because these multinational institutions are typically large so there is more public hard data available (Berger & Udell, 2006). As the soft information might be harder to communicate inside a large organization the small institutions with less layers in management might have an advantage in relationship lending (Berger & Udell, 2002). Soft information accumulates over time and it can be measured by the length and strength of the relationship between a bank and an SME (Moro et al. 2014). Berger & Udell (2000) even suggest, that soft data might even contain information about the character and the reliability of the firm’s owner. However, soft information is hard to communicate within the financial institutions and it is often rather in the loan officers’ minds than in the company’s databases (Berger & Udell, 2006). Scott J. (2004) argues, that soft information is more qualitative and is subject to interpretation of the gatherer. Thus, it is not so easily transmitted inside the organization as hard quantitative data. Berger & Udell (2006) argue, that most of the used transaction technologies are designed so that they use hard information other than financial statements to underwrite loans to opaque SMEs. Based on survey data on 433 bank-SME -relationships in northern Italy the information that the entrepreneurs disclosed voluntarily influenced the loan manager’s perception of competence over and above the effects of publicly available hard financial figures and other information (Moro et al. 2014). Berger & Udell (2002) also argue, that because the loan officers typically live in the local communities, they have contacts with other local firms and individuals and because of that they are able to gather additional relevant information about the firms. However, I am not sure how broad image one can get of the local businesses and so on unless one lives in a really small community. In addition, Berger & Udell argue, that market power reduces credit access through any of the lending technologies; institutions with more market share can charge higher rates or fees, because they might have tight credit standard and they do not have to be so aggressive in finding customers. Previous research also suggests, that larger banks allocate less loans to SMEs than small banks (Cole et al., 2004). Also, Alessandrini, Presbitero & Zazzaro (2009) found out, that the geographic distance between the bank and the borrower affects the lending process so that with distant customers the banks tend to rely more on the hard information. However, the effect of this could be decreasing over time, as information technology gets better and better and increasing amount of loan discussions are conducted online instead of having a meeting at the bank premises.

2.3 What is trust and how it affects the lending process

The actors in any trust-related relationship are the trustor (one who has expectations of another) and the trustee (one who is the object of trust), from whom the trustor expects favorable intentions and actions based on the level of trust. According to Möllering (2006) Denise Rousseau et al (1998) suggest a widely supported definition of trust as a psychological state which includes the intention of accepting vulnerability because of having positive expectations of the intentions or behavior of another. Thus, simply put, trust is a state of expectation of trustors who make themselves vulnerable by expecting no harm. According to Nooteboom (2002, 2) *"Trust can have extrinsic value, as a basis for achieving social or economic goals. It can also have intrinsic value, as a dimension of relations that is valued for itself, as a part of a broader notion of well being or the quality of life."*. When talking about the intrinsic value of trust Nooteboom argued, that it can be based on hedonism or self-respect, as people often prefer trust-based relationships over relationships that are based on suspicion and opportunism. Nooteboom divided behavioral trust to different forms, of which I believe intentional trust and competence trust to be the most important forms in bank-SME relationships. Nooteboom argues, that a setting where actors intentions include their aims, motives and such to perform to the best of their competence yields intentional trust. According to him intentional trust can be expanded to institutional trust, which means that one trusts institutions such as law, police or government. Nooteboom also argues, that even though institutions are man-made, they are based on collective series of actions in a long run. I believe, that institutional trust would be the main explaining factor, when thinking about why a certain SME trusts a bank. About competence trust Nooteboom (2002, 50) argues the following *"Another cause is the competence one needs to achieve expected* *performance, such as abilities, skills, and knowledge to needed to use technology, employ proper methods, communicate and collaborate in teams, plan and co-ordinate activities, and so on. This constitutes competence trust."* Thus, when the bank is thinking about the probability of an SME for paying their loans back, I believe that they focus on these two forms of trust and their implications in addition to hard data.

Nooteboom (2002) argues, that not just individual persons, but also collectives and entities can be referred to as trusting or trusted actors, if one can meaningfully link expectations and actions to them. Thus, according to Nooteboom objects of trust can be organizations, institutions and socio-economic systems as well. Another important aspect is that one must be able to identify the roles of different players when talking about trust. For example, Möllering (2006) says that to speak of trust one has to be able to identify trustors and trustees accordingly. Nooteboom (2002) has noticed the same thing and he argues, that recognizing the two-sidedness of trust is the most basic point for analyzing trust. By two-sidedness he means the roles of a trustor and a trustee. Möllering also emphasizes on the importance of recognizing that the trustor and the trustee are embedded in a social context, which influences the way they can define themselves in their roles and enact their agency according to them. Thus, trust is not just an issue between two individual actors, but a phenomenon which usually contains a context, a history and other factors that matter.

I believe, that trust between the SMEs and banks is extremely important when using the relationship lending technique. In 1995 Mayer, Davis & Schoorman suggested, that trustworthiness is based on three factors, which are ability, benevolence and integrity. Ability focuses on such aspects as skills and competence. Thus, it is domain-specific, and it might not be able to generalize it to other situations. Benevolence is relationship-specific, and it means the extent of a trustee would voluntarily do good to the bank or other trusting party. Integrity relies on the trustor's perception of the trustee adhering to a set of principles that the trustor has considered applicable. In conclusion Moro & Fink (2013) found out, that when a loan managers score a customer highly on trust and the components of it (ability, benevolence and integrity) their access to credit improves. In addition, their econometric findings underline, that relationship lending cannot be simplified to facts and figures. They also argue, that the role of trust might even be greater and more important to very small firms that are unable to provide the hard data required by banks. Their study also indicates, that trust plays a far more important role in relationship lending than it has been acknowledged so far. Moro, Fink & Maresch (2015) also argue, that reduction in information asymmetry has a positive effect, such as getting a higher amount of short-term credit, in the lending process. The empirical results from a study by

Moro et al. (2014) point out, that the voluntarily disclosed information is assigned a significant role. They argue, that when entrepreneurs disclose information, the loan managers reciprocate by allowing more flexible banking relationships. Thus, the loan managers give the entrepreneurs some incentives to disclose additional information. Moro et al. (2014) summarized, that publicly available hard financial data, soft information and voluntarily disclosed information each have a role in the loan manager's thoughts of the entrepreneur's competence. In particular behavior that leads to information disclosure increased the perceived competence and reduced the perceived threat of opportunism in the mind of loan managers. According to Moro et al. (2014) this has led to lower interest rates for entrepreneurs who have provided high quality information to the loan managers. Berger & Udell (1995) also argue, that their evidence indicates that small firms with long relationship get loans at lower rates and they have fewer collateral requirements than other small firms. On principal-agent research Möllering (2006) notices, that sometimes it is not the incentive-based trustworthiness that makes a principal-agent relationship efficient, but the "cost-free" trust that comes as a given premise based on the relationship. In such cases trust is rather a solution to agency problems than being a source of agency problems. However, it is believable only if the theory is not being followed strictly and some non-rational motivations are included in it. According to Möllering many rationalist theories explain trust as a matter that makes a rational actor seem trustworthy, but these theories fail to explain the simple fact, that when dealing with trust one has to deal with other means than solely pay-off calculations or such purely rational methods. In addition, Welter (2012) argues, that trust has been seen to assist in lowering transactional costs of commercial actions. On the contrary Degryse & Cayseele (2000) found out, that there is a sort of a lock-in effect, which means, that the SMEs might get stuck with a certain bank and a longer relationship duration actually leads to higher interest rates on loans. However, I do not believe that this would happen often. Moro et al. (2015) argue, that SME managers often believe, that being straightforward in loan discussions could have a negative effect, because loan managers might interpret figures on a negative way or overreact to them. However, they noticed, that actually additional information helps loan managers in various ways when evaluating firms. For example, more information helps the loan managers to get a clearer idea of the firms' financial needs, cooperative behavior is appreciated and as long as new information builds up to a creditworthy feeling of the firm the loan managers they want to reciprocate with supportive behavior

It is also important to keep in mind, that trust does not always come without problems. Relationship lending requires more authority given to the loan officer that has the greatest access to the soft information. This greater authority creates agency problems within the institutions that necessitate various organizational balances. (Berger & Udell, 2002). Furthermore, Moro et al. (2014) argue, previous research suggests, that high level of trust could lead to an even higher risk of fraud. Additionally, they argue, that over-reliance on voluntarily disclosed information could lead to a situation where the loan manager would be blind to obvious difficulties in the firm. Also, if a loan officer is fired or quits their job the soft information related to a customer or a group of customers might be lost. However, it must be kept in mind, that the new innovative and entrepreneurial firms often rely on their new products and new technologies, that cannot always be protected by patents and brands and such (Himmelberg & Petersen, 1994). Thus, by disclosing additional (sensitive) information such as their product details, performance and strategies, the SMEs take a risk, that the bank could intentionally or unintentionally leak their information to competitors or other entities. This is why trust is needed both ways. On the other hand, disclosing less information might lead to having worse terms on the loan, so it might not be the best idea to try to disclose as little information as possible.

2.4 Sources of trust and role of trust in bank-SME relationships

Nooteboom (2002) argues, that having the distinction between the trustor and the trustee is especially important, when thinking about the foundations of trust, which can be further on split to reasons for trustworthiness and sources of trust. For example, Williams (1998) divided sources of trust to “macro” sources which have institutional origins and are general and impersonal, and “micro” sources, that are personal and arise in specific relations. Nooteboom (2002) divided building trust in three major stages, which were 1. control in the absence of trust, 2. assessing trustworthiness and developing tolerance levels of trust and 3. widening these tolerance levels. In the first stage there are no basis for trust, so trustworthiness must be demonstrated in some way. Nooteboom argues, that at this point the trustor must think about opportunism and possible lack of competence. He suggests, that one way move further in this situation is to proceed with small steps without having a lot of risk. Demonstrating trustworthiness could, for example, include discussions and providing information. Also, first impressions and intuition have a big role at this stage. Nooteboom argues, that in the second stage there are some basis, for example knowledge and experience, over which further trust can be built on. At this stage previous experiences and discussions can be evaluated and tolerance levels for trust can be set. Inside these tolerance levels the relationship can be developed further. Further on, Nooteboom explains, that in the third stage the tolerance levels can be widened, and the relationship can be honed. Nooteboom argues, that by the third stage one might have developed empathy for their partner’s objectives and weaknesses, which might lead to, e.g., surrendering their own control and accepting more control from the partner or accepting more risk because of the good relationship.

About the stages in general Welter (2012) mentions, that these stages might overlap, and they do not always occur sequentially and Nooteboom (2002) also argues, that all three stages do not necessarily arise. However, Welter (2012) noticed, that further research is needed on understanding the exact mechanisms on how trust is destroyed and repaired in entrepreneurial relationships.

According to Moro et al. (2014) soft information accumulates over time in a relationship, but disclosing additional information voluntarily is influential in lending relationships between banks and SMEs. A logical conclusion from this is, that increased trust leads to a setting where information is shared with less friction, which ultimately leads to lower amount of information asymmetry between banks and SMEs. Also, Moro & Fink (2013) argue, that if banks rely solely on transaction lending they cannot evaluate SME managers properly, which leaves out many good SMEs. They argue, that by relying on trust and perceived ability plus benevolence and integrity the loan managers can more effectively make a distinction between good and bad customers. They also argue, that role of trust might be greater and more important in the case of very small firms which lack the potential to provide banks with all the facts and figures they require. Finally they conclude, that when thinking about accessing bank finance it is not the best strategy to refrain from disclosing information and altogether reduced information asymmetry is associated with more credit.

3. Data and methods

3.1 Data collection

The main question in my study is “How is trust between banks and SMEs established and how it affects the lending process?”. In addition to the literature review I decided to conduct interviews to acquire empirical research data in a qualitative manner. According to Creswell (2013, 44) *“Qualitative research begins with assumptions and the use of interpretive/theoretical frameworks that inform the study of research problems addressing the meaning individuals or groups ascribe to a social or human problem. To study this problem, qualitative researchers use an emerging qualitative approach to inquiry, the collection of data in a natural setting sensitive to the people and places under study, and data analysis that is both inductive and deductive and establishes patterns or themes. The final written report or presentation includes the voices of participants, the reflexivity of the researcher, a complex description and interpretation of the problem, and its contribution to the literature or a call for change.”* Based on the literature review I had some assumptions, which I wanted to test by conducting interview. My plan was to use data gathered from interviews as a primary source of data. I gathered the primary research data by interviewing banks and SMEs on phone and/or in face to face meetings. If interviewing banks and SMEs would not have provided enough information I had the option that I could include interviews with so called shadow banks in my study. Shadow banks are institutions, that lend money against collaterals, but are not under bank regulation and do not have savings accounts like traditional banks.

To assure that I receive useful information from the interviews I gathered some information from literature related to interviewing. For example, I learned, that Eriksson & Kovalainen (2011) describe three types of interview studies, and one of them is called “emotionalist” or “subjectivist”. In that kind of a study the interviewer does not so much focus on information, but on, e.g., people’s perceptions, viewpoints and emotions. Instead of asking “How much do you trust your bank on the scale one to five, if one is non-existent and five is 100 %?” one could ask “Do you trust the bank and how do you feel about the relationship with the bank in general?”. According to Brinkmann (2013) semi-structured interviews enable the interviewer to become a visible and a knowledge-producing participant in the interviewing process. Brinkmann also says, that semi-structured interviews give the interviewer a greater saying in focus of the conversation so that it focuses in the issues that are considered important or closely related to the research project. I decided to use semi-structured interview guides (Annex A) while performing the interviews to ensure, that all the important research questions are answered and at the same time the interviewees can tell anything else they have in mind about the subject. Taking care that everything gets answered in semi-structured interviews is perhaps the most challenging part according to Eriksson & Kovalainen (2011). To mitigate that risk, I decided to use two different sets of questions, as the questions need to be a bit different depending on when I was interviewing a SME and when I was interviewing a bank. I thought this kind of approach would be the best way to gather empiric research data, as the nature of trust and so-called soft information are something that cannot be easily transformed to words and numbers. Thus, interviewing, listening and understanding was the key. Eriksson & Kovalainen (2011) describe a guided or semi-structured interviews as an interview, where the interviewer has prepared an outline of topics plus issues or themes and has a possibility to, e.g., change the wording and order of questions in the interviews whenever needed. However, I did not send any questions to the interviewees beforehand, because I was not making a survey. It would have also been interesting and perhaps very insightful to be present, when a bank representative is meeting a SME representative that is trying to get a loan. However, I did not try to get into a meeting like this, because I thought it would not be possible due to the sensitive nature of the information and the bank secrecy rules. Thus, I thought, that the only thing I could do to gain empiric research data was to interview bank and SME representatives on their own. Barbour (2011) writes, that it might be hard for a novice interviewer to follow and make sure that all the questions of the guidance interview are answered, when respondents jump from one topic to another. Eriksson & Kovalainen (2011) also argued, that this interviews with a semi-structured form usually works well if the interviewer is a bit experienced in doing interviews. Before writing this study and conducting the interviews I had conducted about 40 face-to-face interviews and about 20 telephone interviews during the previous 12 months, so I felt confident moving on.

I focused on interviews, because using email questionnaire forms or such could have provided low value information and perhaps the nature of research data would have been more quantitative data versus proper face to face interviews. An interesting thing to try would have been to interview both sides of the same relationship. I mean, that I would have been able to interview a representative of an SME and then their designated loan officer as well. Unfortunately this was not possible because of a tight schedule. Of course, performing interviews was time consuming. However, I thought, that after conducting a thorough literature review I would have developed an intuition about how trust works between bank-SME relationships. Later I could see if it was supported by the information I received from interviewing banks and SMEs. I thought, that a dozen interviews could be enough to back up my literature review -based thoughts. I was also prepared to conduct additional interviews, if there was a lot of differences between answers from different interviewees and I would not get to a more or less saturated point by interviewing a dozen banks and SMEs in total. My plan was, that after conducting those interviews, I would see whether I have received new information from the final interviews or not. Even though the amount of interviewees was not large I thought, that it would be important to interview SMEs and banks of different sizes and from different (urban and rural) locations to see if the results are similar. I thought that on the bank side the appropriate interviewees are loan officers or such and on SME side I would try to interview e.g. chief executive officers or chief financing officers. The interview language would be Finnish, because I was looking for interviewees only in Finland. Also, I decided that I would record the interviews when possible and before the interviews I could tell interviewees that I am making a thesis about bank-SME relationships. I was told, that it might be good to let the interviewee bring up the word "trust" instead of the interviewer, and that is what I did. I was hoping to perform face to face interviews (e.g. in the premises of the SMEs/banks or in a coffee shop) rather than phone interviews, because impressions and body language matter when performing qualitative interviews. However, due to restricted amount of time and long distances between me and different interviewees I had to conduct all but one of the interviews by phone. To inspire confidence in the interview situation I decided to be as open as possible about myself and my study. To avoid any ethical problems in this kind of a study and to gain trust of the interviewees it was important to tell the interviewees, that the data would be anonymized and used only for study purposes. According to Graham (2012) an investigator might hear details that only good friends could otherwise hear. He also writes, that because of the detailed nature of qualitative data there is a danger that a breach in confidentiality might occur. Thus, anonymizing the data is especially important. Hence I acknowledged that I have to be very attentive when I am writing my findings on paper.

Finally, I conducted 10 SME interviews and three bank interviews. After these interviews I noticed, that the information I received from them had a lot of similarities. Thus, I felt like conducting additional interviews would not provide much new information, so I did not look for additional banks or SMEs to interview and left the shadow banks out.

3.2 Analyzing and presenting data

Many previous studies argue, that more trust lead to lower interest rates and better loan terms in general, but I wanted to find out if that is the case with the SMEs as well. Main questions in analyzing the data were what I have found and what is the significance of those findings. Also, I had to think about what are the consequences of the findings and what can be concluded based on the findings.

Finally, I had to compare the findings to earlier discussion on the topic and see how data from the analysis answer to my research problem.

Creswell (2013, 179) argues the following: *“Analyzing text and multiple other forms of data presents a challenging task for qualitative researchers. Deciding how to represent the data in tables, matrices, and narrative form adds to the challenge. Often qualitative researchers equate data analysis with approaches for analyzing text and image data. The process of analysis is much more. It also involves organizing the data, conducting a preliminary read-through of the database, coding and organizing themes, representing the data, and forming an interpretation of them. These steps are interconnected and form a spiral of activities all related to the analysis and representation of the data.”* I started analyzing the data by listening to the interview recordings and thought about what parts of the interview would be useful in my study. According to Holliday (2007) a solely thematic approach where all the data is rearranged under themes is a classic way to do it. Additionally, Creswell (2013) argues, that he often starts with 25-30 different categories of information, but reduces and combines them until there is only five or six themes left. Thus, after conducting the interviews I transcribed some parts of the interviews when needed and coded the answers two different main groups, which were quotes related to relationship quality and soft information inside the bank-SME relationship and quotes related to trust. I identified these two themes to be central for my research problem as they are in the core of bank-SME lending processes and are firmly tied together. Without soft information there is no loan process and without a certain level of trust the process of transmitting soft information might become inconvenient, which would cause information asymmetries. Thus, there was no obvious need for additional themes, as interview data related to these two themes provided me enough information for my research problem. The consequences of the findings could be, e.g., that SMEs are given information on how to have a fluent relationship with a bank and how to improve their interest rates and terms of the loan. I thought that I might also be able to identify other common themes, if there are any in my pool of interviews. Finally, I noticed that three main themes that came up in the interviews were role relationship quality, role of soft information and thoughts related to trust, but not always exactly about trust.

As for presenting data from my interviews I decided to go with short eye-catching quotations from the interviews related to two previously mentioned themes. According to Creswell (2013) such quotations should be easy to read, they should not take too much space, they should stand out from the narrator's text and signify different perspectives.

4. Empirical results

According to Fauchart & Gruber (2011), social identity theory concerns the structure and function of identity as they relate to an individual's social relationships and their membership in groups or social categories. Prior studies have emphasized on key social aspects of self-concept, for example basic social motivations which shape the behavior of individuals when they engage with others. (Brewer & Gardner, 1996). Furthermore, previous studies argue that because person's identity acts like a cognitive frame for interpreting experience, individuals are more likely to act consistently with that identity. (Hogg, Terry, & White, 1995; Stets & Burke, 2000). Thus, when analyzing interview data I focused on information related to relationship quality and soft information inside the relationship, because acting consistently in a certain way leads to a certain kind of identity which develops over time. I wanted to find a link between the actions of the trustees and the perception of trustworthiness from the trustors side. Another theme in my data analysis was information related to trust itself. By working on these two themes I found out 1. what kind of behavior promotes trust and how does it emerge and 2. what do the interviewees think about trust. Furthermore, this information was analyzed from two different viewpoints; from a bank role and from an SME point of view.

As empirical data I was able to use interview transcripts from 10 SME interviews and three bank interviews I had conducted in early 2018 as a part of another project, which was also related to trust and relationships between banks and SMEs. The SME interviewees had participated in another study in 2015 and they had been divided to two groups. Group 1 had reported problems related to growth project funding and group 2 had not reported problems related to funding. The interviewed SMEs were of different sizes and fields of business and also from both rural and non-rural locations in Finland. The bank representatives I found on my own via social media. The interviewed bank representatives were from large banks around Finland and the interviewed SME representatives included companies of various sizes and locations. All of the bank representatives worked under the title of banking advisor and most of the SME interviewees were chief executive officers or financial managers.

The interviews were conducted in a manner, which was similar to my data gathering plans for this study. When conducting the interviews, I agreed on treating the data gathered from the interviews anonymously. Thus, I cannot provide individual information on the quotes included in this chapter.

4.1 SME interviews

Background information

Average relationship length between interviewed SMEs and their banks had been approximately 15 years. The shortest bank-SME -relationship had lasted five years and the longest relationships had lasted tens of years.

The SMEs relationship to the current contact person in the bank had lasted 6-7 years on average. The shortest relationship had lasted two years and the longest had lasted almost 20 years.

Based on this information one can notice, that these relationships last for years or even tens of years on average. Thus, it is important to understand, that these relationships work like a slow ongoing processes rather than quick project-like decisions.

Relationship quality with the contact person

On average the relationship quality with the contact person were described as good or excellent. Half of the relationships (5/10) with the contact persons were described as be good. Three interviewees said, that the relationship with the contact person was excellent. *"We have a really good relationship with the contact person. They have proactive service and they understand the needs of our company, they try to help us, they are experts in their field of business and they are easy to deal with." (Medium-sized housing company, Southwest Finland).* One interviewee said, that they had good relationship with the previous contact person, but that person got laid off and a new contact person has not been appointed. Another interviewee said, that they do not meet too often with the contact person and their relationship is mediocre.

All of the interviewees said, that they would hope to be always able to do business with the same contact person. *"I wish, that I could always deal with the same contact person. Unfortunately, that is not realistic." (Medium-sized timber company, Western Finland).* This is understandable, as building trust and getting to know each other takes time. Most of the interviewees (8/10) said, that they do not know the contact person outside the professional relationship. One interviewee said, that they sometimes see each other in the city, but they do not have any kind of relationship outside the bank-SME relationship. Another interviewee said, that they spend time together with the bank representative outside the professional relationship. Both of these interviewees, who knew the bank representative outside the professional relationship, were from small cities. I felt like knowing the bank representative outside the professional relationship had not affected the lending process. However, this is just my intuition and I have no proof to back it up.

About the bank contact person knowing the SME (their business) outside the professional relationship half of the interviewees said, that the contact person does not know the company outside the professional relationship. However, long relationships with the same contact person have provided a broader image of the companies. In smaller cities it seemed to be so, that everyone knows each other. Thus, the other half of the interviewees said, that the contact person of the bank also knows the company outside of the professional relationship. Three out of five (3/5) interviewees, who said that the contact person knows the company outside the professional relationship thought, that knowing the company makes the loan process faster and more convenient. *"We know each other outside of the professional relationship and we know about each other's family relations and hobbies and we have spent time together in non-professional events." (Medium-sized bakery, Western Finland).* Finally, two out of five (2/5) interviewees said, that they do not know if it matters whether the contact person knows the company outside the professional relationship or not. I believe, that in small communities' word of mouth goes a long way. Thus, I believe, that in small communities a loan officer might not be able to avoid knowing the SME outside the professional relationship, which I believe to lead to an even more deep understanding of the SME.

Relationship quality with the bank

The relationships with the banks were described to be good on average. Six out of ten (6/10) interviewees said, that the relationship is good. In addition to that three interviewees said, that the relationships were excellent. *"We have very good relationship with the bank. They are a local company and we know people from the company." (Medium-sized bakery, Western Finland).* However, one interviewee said, that the relationship is completely one-sided and the bank is not proactive at all. Another interviewee said, that the importance of bank relationships has decreased a lot.

Role of soft information

On average the SME representatives tried to be very open when having discussions with the loan officers. This can be directly linked to what Nooteboom (2002) described as intentional trust; these SME representatives do their best to seem trustworthy towards the bank, because their intention is to get the loan they are looking for. Based on the interviews it seemed, that according to SME representatives the so called free from discussions, that include lot of soft information, have a mediocre to large role in the lending process. Interviewees said things like:

"We think that the voluntarily provided additional information that we give in the discussions in the lending process have a mediocre role." *(Small machinery company, Western Finland)*
"We have a lot of discussions during the lending process and I think they have about a 50% weight in the whole process." *(Medium-sized bakery, Western Finland).*
"The lending process includes discussions, in which additional information is provided. I think these discussions have a big effect on the process." *(Medium-sized excavation company, Northern Finland)*
"We have free form discussions on phone when we are in the lending process and the information shared in these discussions have a very significant role in the process." *(Medium-sized plastic producer, Southern Finland)*
"The lending process includes free form discussions and they do play a pretty big role." *(Medium-sized staffing company, Southern Finland)*
"In the lending process we meet with the contact person and share additional information, which has a big effect on the whole process." *(Medium-sized scrap trading company, Western Finland)*
"We have free form discussions in the lending process in which we talk about things that cannot be explained on paper and they have a really big role." *(Medium-sized timber company, Western Finland)*

The free form discussions were found to make the whole interview process smoother. For example, one interviewee said, *"The discussions in the lending process and the voluntarily disclosed information related to them make the process smoother." (Small real estate company, Central Finland).* Also, the SME representatives said that they would provide loan officers with any additional information if it would lead to better loan terms. Interviewees said things like *"Of course we would provide banks with additional information, if it would give us access to better terms on the loan." (Medium-sized housing company, Southwest Finland)* and *"Of course we would give banks any additional information, if it would have a positive effect on the terms of our loan." (Small property management company, Southern Finland).*

As stated in my literature review (2.4) Moro et al. (2014) soft information and especially additional voluntarily disclosed information is influential in lending relationships with banks and SMEs. Also, Moro & Fink (2013) argued, that role of trust might be greater and more important in the case of very small firms and reduced information asymmetry is associated with more credit. I think, that that in practice any free form discussion includes voluntarily disclosed additional information even though the participants of the discussion do not acknowledge it per se. Furthermore increased trust in general leads to more straightforward communication, which ultimately reduces information asymmetry.

Thoughts on trust

During the interviews I found out, that none of the interviewees were worried over how banks use the information they receive from their clients. This seemed like a standard, which seemed to be based on Finnish society being a society where trust is generally high. Also, the bank secrecy requirements make people trust the banks and banks as institutions have a long history of being trustworthy when it comes to information secrecy. If banks do not follow the secrecy requirements they lose their banking licenses, which would be the end of their business. Thus, being trustworthy is the cornerstone of banking business and the information I received from SME representatives included lines like:

"We are not worried about how banks use the information that they have received from us. We trust the banks." *(Medium-sized housing company, Southwest Finland)*
"We are not worried in any way about how banks use the information that they have received from us." *(Medium-sized plastic producer, Southern Finland)*
"We are not afraid about how banks use the information that we have provided to them. We deliver what they ask for." *(Medium-sized staffing company, Southern Finland)*
"We give all the requested information to the banks and our financials are public information, so there is nothing to hide." *(Medium-sized scrap trading company, Western Finland)*
"We trust the banks and we proactively send to the banks a description of our investment, the and a budget and a financing plan for it." *(Medium-sized timber company, Western Finland)*

One form of trust Nooteboom (2002) described is intentional trust, which can be expanded to institutional trust, which means that one trusts institutions such as law, police or government. This form of trust seemed to play a major role when thinking about why the interviewed SMEs trust banks. Even though SMEs did not bring up role of trust per se I noticed, that the bank-SME relationships would not be fruitful without trust, as the amount of disclosed information would be lower in a low-trust environment. Based on these findings the level of trust is high between banks and SMEs. Also, the findings (role of soft information from the SMEs point of view) indicate, that soft information has a mediocre to significant role in the lending process. Thus, I am not surprised, that the interviewed

SMEs felt on average, that their relationships with banks and their representatives are good or excellent.

4.2 Bank interviews

Background information

All the interviewees said, that the quality and the length of the relationship affect the lending process so, that in long relationships it is easier and faster to deal with the financing needs. In long relationships the SMEs and banks know each other well. Thus, less discussion and less background research is needed and in the best cases individual (additional) loan discussions can be as short as one phone call. Also, all the interviewees said, that the quality of the relationship has a major role in the process. Nooteboom (2002) argues, that recognizing the two-sidedness of trust is the most basic point for analyzing trust. In my interviews the bank representatives stated, that if the relationship is good and the trust goes both ways, the lending process is much more convenient. This finding is similar to the literature review in this study as well as the findings from the SME interviews. However, if the bank requests some information and the company does not provide the information it lowers the trust, or even stops the lending process completely. Banks request for information they perceive important and if they do not receive this information the loan process simply cannot be taken further.

In the interviews trust came up especially when discussing about new customers, who are not always so eager to send all sorts of information to the banks. However, in general the interviewed bank representatives had a feeling, that usually the SME representatives trust the banks, which also seems to hold based on the previously described SME interviews. Also, banks take good care of the customer data because of the bank secrecy requirements. Firstly, information is kept and accessed only in the banks internal systems and only when they need to be accessed in a professional manner. Secondly, banks delete all the customer information when it is no longer needed. What comes to transparency of the lending process all the interviewees said, that the internal discussions in the bank are not to be heard by the customers. However, all of the interviewees said, that they try to make the lending process as transparent as possible and the SMEs usually know what is happening and why.

Role of soft information

During the interviews it became clear, that bank representatives also think, that soft information received in free form discussions play a big role in the lending process. These discussions provided information of the SMEs business in addition to the financial data and other hard data. The discussions also included information that could not be described on paper and provided a glance of the entrepreneur’s competence, for example. In the end the interviewed bank representatives seemed to think, that without free form discussions and gathering soft information a lending process cannot be completed. Quotes related to soft information included the following statements:

"The wider image about the nature of the customers’ business comes only via discussions and it might not be possible to describe it on paper." *(Large bank, Southwest Finland)*
"The voluntarily given information has an important role in the lending process. The financial statement tells the situation for only one day, but many other pieces of information are needed." *(Large bank, Southwest Finland)*
"The additional “soft” information affects the lending process; everything affects everything.” *(Large bank, Southwest Finland)*
"The largest role is with the discussions that we have during the lending process. Of course the financials and other hard data are a must-have in the process." *(Large bank, Southern Finland)*
"We do not focus just on numbers and papers, but the case as whole is what matters. For example the persona of the entrepreneur affects the lending process." *(Large bank, Southern Finland)*
"Of course the additional "soft" information has affected the lending process. We do not request for any information if it is not needed." *(Large bank, Southern Finland)*
"The most important information is the information what we gather from the discussions. The general state of the company and the full image of what is happening is best acquired by having discussions. These discussions often include information, that cannot always be communicated on paper." *(Large bank, Western Finland)*

"The history of the customer is important. How they act matters as well as how they have dealt with their loans and have they been in contact with us if they have experienced problems in paying their loans back." *(Large bank, Western Finland)*
"Sure the additional information affects the lending process. The more the customer provides us with information the better.” *(Large bank, Western Finland)*

Moro et al. (2014) argue, that soft information accumulates over time in a relationship, but disclosing additional information voluntarily is influential in lending relationships between banks and SMEs. Quotes above strongly support this argument and interviewed banks also acknowledge the crucial role of free form discussions and soft information acquired in these discussions.

Thoughts on trust

About trust the bank representatives said, that increased trust leads to a more convenient lending process. Also, the interviewees said, that trust has an important role in the process. Neither did I find any information that would support the hypothesis from my literature review, that higher trust would lead to lower interest rates for the SMEs. About trust between banks and SMEs the interviewees could not provide any specific thoughts on why they believe that the SMEs trust banks in general. It seemed to be so, that it is just the way things are, which takes us back to the concept of institutional trust.
About what makes banks trust SMEs I learned, that everything in the relationship matters. Hard information, such as financial statements matter of course, but the thing that matters most is the soft information, which comes up in the free form discussion between the SMEs and the banks. Without previous history with an SME intuition about the competence and trustworthiness of the SMEs representatives matters as well. Some trust-related statements from bank interviews can be found below.

"It is easier and faster to deal with a customer that we trust and have known for a long time.” *(Large bank, Southwest Finland)*
"It is easier to work with a customer that already knows us and trusts us." *(Large bank, Southern Finland)*

"If a customer has a long relationship with us and we trust them it is easier to make a decision on the loan than with a new customer." *(Large bank, Western Finland)*
"The quality of the relationship is in the center of the lending process. If the relationship is long and good and we trust each other, everything related to the bank-SME -relationship becomes much easier." *(Large bank, Southwest Finland)*
"Trust is really important and especially with new customers we notice, that because lack of trust they are not so eager to provide all sorts of information to the bank and they do not always want to send information via email, if they consider the information sensitive." *(Large bank, Southern Finland)*
"In new customer relationships more discussion is needed in the beginning, because there might not be any trust yet if the customer is a new one." *(Large bank, Western Finland)*
"Mutual trust has a very significant role in the lending process." *(Large bank, Western Finland)*

These statements go hand in hand with my intuition, that in bank-SME relationships a high amount of trust improves the quality of the relationship and the lending processes in general in various ways. Also, Nooteboom (2002) argues, that people often prefer trust-based relationships over relationships that are based on suspicion and opportunism. My findings from the interviews support this observation, as banks acknowledge that trust has a significant role in the lending process.

5. Discussion

5.1 Reflection on the interviews

During the interviews I did not find any major differences between different interviewees and their thoughts. The size or the location of the SME did not seem to have an effect on the bank-SME relationships. However, my study included only SMEs and no large companies from the trustee side were interviewed.

Based on earlier research it seemed clear, that strong bank-SME -relationships take time to build up, lead into more trust and more information disclosed. When developing the relationship and establishing the foundations for trust from the bank-perspective it seemed, based on the interviews, that in the beginning of a new relationship intuition (e.g. trusting one's competence, ability trust) has a big role and it would rise from the free form discussions. If the relationship between a bank and an SME continues it develops further, relationship history, such as acting as expected and keeping their words starts to weigh more. Thus, building or disassembling trust is based on consecutive actions in the same direction. From SMEs perspective trust was mainly based on institutional trust and the history of banks as trustworthy institutions inside the Finnish society. In previous studies strong relationship is shown to lead for example to a faster lending process and lower interest rates. My interviews with SMEs and banks supported the hypothesis, that strong relationships and higher levels of trust lead to faster lending processes. However, the information I received from my interviews did not support the hypothesis, that strong relationship would lead to lower interest rates. In addition, Degryse and Cayseele (2000) argued, that SMEs might get stuck with a certain bank and a longer relationship could then actually lead to higher loan rates. I do not believe that this would be happening on a broader scale. I do not have personal experience of enterprise loans, but at least with the mortgages it seems, that the longer one has been a customer of a certain bank the lower are the interest rates that are offered. However, this might not be the case if one has not taken good care of paying the mortgage and credit card bills within the schedule. Also it seems clear, that trust has a big role in the relationships between banks and SMEs.

5.2 Practical implications

When thinking about bank SME relationships and the lending processes related to them it is certain, that financial numbers and other hard data are mandatory information in any lending process. However, it is important to acknowledge, that trust and soft information shared in free form discussions are in the center of the whole process. Without trust and soft information the relationship-based lending processes would not be possible in the first place. In some cases it might be hard to figure out whether a new SME whose looking for a loan is actually able to pay the loan back. However, as stated in this study, intuition based on initial discussions during the lending process and high basic level of trust inside the Finnish society go a long way. Based on the interviews conducted during this study one could argue, that information asymmetry in bank SME relationships is skewed towards the banks. This is true, of course. However, it is a natural consequence of the fact that banks are the actor who are giving out loans and it resembles a classical principal-agent problem. If banks make bad decisions when giving out loans they experience credit defaults. On the other hand it is in the intentions of the SMEs, that they pay back their loans, keep the business running and have the option for further loans if needed.

5.3 Limitations of the study

One blank spot in this study is that during the process of writing it I did not encounter SMEs who have had a hard time acquiring the loans they have been looking for. Neither did I encounter SMEs, who do not trust banks with information they consider sensitive. Another thing to keep in mind is that the SMEs I interviewed were not completely randomly picked, but taken from a list of SMEs that had participated in interviews in 2015. However, I do not think that this fact had any major influence in the results of the study. Third limiting factor in my study was restricted amount of time and not being able to conduct most of the interviews face-to-face.

5.4 Further research

Reducing information asymmetry would benefit both the banks and the (good) SMEs. Furthermore, it would be useful to conduct more research of the area so that companies on the both banks and SMEs would be able to use the information and adapt their processes if needed. Also, more research is needed in order to understand, whether the reduced information asymmetry has a large effect on the terms of the loans, or is speeding up the lending process the main effect of it.

It has been argued in some previous studies, that some SMEs might not be so keen to send sensitive information to banks because lack of trust. However, the SMEs I interviewed during this study did not worry about sending sensitive information to banks. Thus, interviewing SMEs who have had some trust issues with banks would be another area for further research. At least I would like to know why they do not trust banks with the information, are they familiar with bank secrecy requirements and what should banks do to gain their trust. Another research subject related to bank-SME trust would be to find out if there are cases, in which SME's have been opportunistic in a way that they have received larger loans than they should receive based on the real status of the company.

One additional area for research could be to find out, whether the lending process in so-called shadow banks is similar to traditional banks. Financial institutions that give credit inside the financial system, but are not subject to regulatory oversight, are called shadow banks. The main reason that makes the shadow banks able to ”escape” the regulation is that they do not accept traditional bank deposits. Thus, they can deal with higher credit and liquidity risks and they do not have capital requirements like traditional banks. I know a person who has founded a shadow bank in Finland and his company gives out credit only when a customer has proper collaterals and seems capable of paying the loan back. In that sense the trust and relationship issues between shadow banks and SMEs could be similar to the relationships between traditional banks and SMEs. However, it would be interesting to find out whether the lower amount of regulation with the shadow banks leads to lower trust from the SMEs.

According to an article in Forbes by Arora (2018) big banks (assets >$10bn) have granted loans to 25.4 % of the applicants. During credit crunches the loan approval rates have gone below 10 %. As sufficient funding is a lifeline for the SMEs they turn to alternative lenders, if banks do not approve their loan applications. According to Arora Amazon announced last year, that they made $1 billion in small-business loans to more than 20 000 merchants over a year in U.S., UK and Japan. Also, they announced, that they have made more than $3 billion in business loans ranging from $1 000 to $750 000 since 2011. The reason behind these loans has been that they have wanted to help SMEs to grow their enterprises via sales in Amazon. Giving out loans is a profitable business and I see no reason why Amazon and other companies, e.g., Alibaba, would not expand their business into lending money. According to Statista (2018) the amount of SMEs in China is expected to grow from ~13 million in 2012 and ~25 million in 2016 to ~43 million by 2020.Thus, the need for SME financing is most likely increasing and more and more of SME loan applications have to be dealt with in the future. One way to deal with risks associated to SME loans could be platform economy and peer-to-peer lending. I believe, that in the future artificial intelligence (AI) will be used in small loans to decide which person or company gets a loan and which one does not. However, these AI’s need to be developed by humans and I believe, that AI’s cannot completely replace humans in the process. Perhaps AI’s will be used as a 1st step of the lending process to see if a person or a company fit loan criteria in any way. Anyway, I believe, that different kinds of financing platforms and their credit scoring systems would provide a large field for further studies related to SME financing.

As the nature of soft information makes person to person relationships very important in relationship-based lending. Most likely it is so, that the SMEs would like to be able to work with the same loan officer every time and this came up a couple of times during my interviews as well. However, the loan officer might resign, get retired, get laid off or be on vacation or sick leave. At the same time banks are trying to have their services running 24/7 and there is a conflict between being available 24/7 versus being able to reach the same loan officer in every occasion. It would be interesting to find out which the SMEs value the more, having the person to person relationship or the 24/7 availability. It could also be beneficial to interview both sides of the same relationship. By this I mean, that one would interview a representative of an SME and then their designated loan officer as well. Also, after understanding the importance of the person to person relationships in the whole lending process it could be researched, that what do banks and SMEs think of this, because it is likely, that in a bank-SME relationship that lasts for tens of years the persons involved might change on both sides. For example, another subject for further research could be that do these companies have any policies which would lead in having the soft information inside the organization when the personnel are changing.

6. Conclusion

This study provides more information on bank SME relationships and the empirical data supported the findings of the literature review in many ways. Based on the literature I included in my literature review I also learned what lending models are used with SMEs, got to know the basis of establishing trust and learned more about the roles soft information and hard information and also about the lending process and the role of trust in it.

Nooteboom (2002) divided building trust in to three major stages (control in the absence of trust, assessing trustworthiness and developing tolerance levels of trust and widening these tolerance levels), and bank-SME relationships seem to follow these stages at least in some magnitude. However, based on this study it seems, that the main reason for SMEs to trust banks is institutional trust, which is based on the fact that banks as institutions have a long history and a trustworthy position in Finnish society. Two main sources of trust from the bank's side seem to be intentional trust and ability trust. Intentional trust arises when an actor wants to perform to the best of their competence to reach their goals and ability trust is based on such aspects as skills and competence of the entrepreneur.

The lending models used with the SMEs are financial statement lending, asset-based lending, credit-scoring lending and relationship lending. The most used one with SMEs is the relationship lending model, in which both hard data (such as financial statements and growth estimates) and soft data (such as discussions between the banks and the SMEs and other not-so-quantitative information) are taken to account. Other models in the above list focus on so called transaction lending, which is a lending model that is based mostly on publicly available financial data. I believe that the optimal lending model would include the most suitable parts of the existing models.

As the soft information might be hard to transmit, small organizations or low organizational models might have a benefit when working on a relationship lending process. However, I did not find literature about how the soft information is transmitted inside an organization. The data is often rather in the minds of the loan officers than in some company databases. Thus, it could be an important subject for further research to find out if the soft information is (actively) transmitted inside an organization and how it is transmitted. Another area of research could be, that do companies somehow take care that soft information is not lost when a loan officer for example resigns or retires.

In the introduction I wrote, that I am not sure if providing more soft information to the banks would affect the lending process, because I thought that banks might request for all the information they need. Based on the interviews I noticed, that everything effects everything and all information is useful. Thus, my assumption about banks knowing what they need and asking for it did not hold.

In previous research it was noticed, that reducing information asymmetry has a positive effect in the lending process, for example increased trust and more information shared might lead to getting a higher amount of short-term credit and lower interest rates. About interest rates and my own experiences with the banks it seems, that interest rates are not based on trust anymore, but they are based on some calculation models which banks use when they are giving out new loans. In the introduction I assumed, that higher level of trust and reduced information asymmetry between banks and SMEs might lead to a faster lending process. Based on my study this assumption seems to hold and both banks and SMEs whom I interviewed support this hypothesis. However, during my study I did not find evidence that would support hypothesis, that banks would provide higher amount of credit or lower interest rates to an SME who they trust. On the contrary Degryse and Cayseele (2000) suggested, that a long relationship between a bank and an SME would lead to higher interest rates. This argument is based on the assumption that SMEs might end up "locked in" with a certain bank, as the soft information that has accumulated during a long relationship cannot be costlessly transferred to another bank. Thus, the switching costs from one bank to another might make some banks take the benefit of it by asking for higher interest rates. However, I do not believe that this would be common and nothing in my study supports this argument.

What comes to whether SMEs trust their information with banks I wrote in the introduction, that solely the bank secrecy requirements might be enough to convince most of the SMEs about information safety. Based on the literature I read for this study and my empirical results I can state, that most SMEs trust banks and that is just the way things are. I did not receive many explanations on this from the interviewees, but one interviewee said, that protecting information is at the core of banking business and without the information secrecy there would be no business for a certain bank. However, I did not encounter any SMEs during my study that would have not trusted banks in general. If banks encounter SMEs who worry over their information secrecy, I would suggest the loan officer to explain how they protect client information and keep it safe. I believe those facts should be enough to convince most of the rational thinkers. Of course there might be cases, where a single individual has misused the information they have received when working on behalf of a bank, but I believe that banks as institutions are trustworthy in general when speaking of information secrecy.

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Annex A

Questionnaire for SMEs

1. **Relationship with the bank**

1.1 How long has the relationship lasted with your current bank?
1.2 How long has the relationship lasted with your current loan officer?
1.3 How would you describe the relationship with the loan officer?
1.4 How would you describe the relationship with the bank in general?
1.5 Do you know the loan officer in any other way but as a representative of the bank?
1.6 Do you wish, that you could always deal with the same loan officer?
1.7 Have you had any positive or negative (trust-related) experiences with the bank?

2. **Lending process**

2.1 How often have you applied for a loan?
2.2 How do you proceed when you need a loan from a bank?
2.3 Do you first contact the contact person or send the loan application straight ahead?
2.4 Have you had any problems with your loan applications? If yes, what?
2.5 What materials have you needed when you have applied for a loan?
2.6 What information do you deliver to the bank? Just what they request, or?
2.7 Would you provide additional information in order to get better terms for the loan?
2.8 Do you think that providing additional information would improve your chances on getting a loan?
2.9 Are you worried how the bank uses the information they receive from you or are you worried, that the information could end up in the wrong hands?

3. Free form discussions

3.1 Does the lending process include any free form discussions?
3.2 If yes, what role have these discussions had?
3.3 What kind of information have you shared in these discussions?
3.4 How do you decide what information do you provide to the banks?
3.5 Does the loan officer know your company from outside of the professional relationship?
3.6 If yes, does it have any effect on the lending process?

Questionnaire for banks

1. **General information**

1.1 Could you briefly describe how the lending process goes in this bank?
1.2 Does the length or quality of the relationship affect the process?
1.3 How do SMEs contact you usually? (phone, email, what?)
1.4 Do the customers ever contact you in unofficial ways? If yes, how?
1.5 Does the way of contacting depend on the type of the customer?
1.6 Are there any cases where the bank would be the proactive entity in the lending process, e.g. based on earlier unofficial discussions?
1.7 Do you think that the level of trust between the bank and a SME has an effect on how much and what kind of information the SME is willing to provide to the bank?

2 Information on the relationships

2.1 How often do you meet your typical SME customers?
2.2 Do you aim to have the same person dealing with the same customer every time?
2.3 What makes you trust an SME?
2.4 What actions lead to decreased trust?
2.5 Do you know your clients outside the professional relationship?
2.6 Does the bank always organize official meetings, or unofficial meetings as well?
2.7 Do the clients organize events where a bank representative is present?

3 Information needed in the lending process

3.1 What kind of information do you need in order to go through the lending process?
3.2 Have you asked for any additional information? What?
3.3 Is there any information that is not so easy to communicate on paper?
3.4 How do you make sure, that the customer information does not end up in the wrong hands?

4 Further questions about the additional information

4.1 What role does the additional information have in the lending process?
4.2 How important is the additional information in the lending process?
4.3 Does it affect the lending process, that on what does the SME intend to use the money on?
4.4 How do you think, that how does a SME decide what information to share with the bank?
4.5 If it is not possible to get a clear image of the SME from financial statements and such, what role has the additional information have at this point?
4.6 Could the lending process be made more transparent for the customer?
4.7 What kind of effect does it have, if the customer does not provide the requested information?

5 Information needed in the lending process

5.1 If you have requested for additional information, how have the SMEs delivered this information to you?
5.2 Has this additional information affected the lending process?
5.3 Do you think that providing additional information helps the SME to get the loan they are looking for?
5.4 Does the provided additional information have a straight effect on the result of the lending process?